
Environmental Funds: The First Five Years

Issues to Address in Designing and Supporting Green Funds

April 1995

A Preliminary Analysis for the
OECD/DAC Working Party
on Development Assistance
and Environment

Foreword

This "typology" of environmental funds has been prepared for presentation to the OECD/DAC Working Party on Development Assistance and Environment by the Interagency Planning Group on Environmental Funds (IPG). It identifies various types of environmental funds and describes the principal issues that must be addressed by the organizers of, and the donors to, such funds.

The Interagency Planning Group is an informal coalition of agencies and organizations concerned with environmental funds. It was established in the fall of 1993 to plan the First Global Forum on Environmental Funds, which was held in Santa Cruz, Bolivia, from 30 May to 2 June 1994. The Forum brought together representatives from 21 national environmental funds, NGOs, and donors to share experiences in fund creation and management and to agree on principles for guiding future development. At the request of Forum participants, the IPG continues to serve as a forum for information exchanges among supporters of environmental funds, as a mechanism for coordinating services and technical assistance to such funds, and as an innovative approach to promoting conservation of the environment and sustainable development.

Agencies and organizations currently participating in the IPG include:

Canadian International Development Agency
(CIDA)
Compton Foundation
Conservation International (CI)
European Commission
The Ford Foundation

The Global Environment Facility-UNDP (GEF-UNDP)
The Global Environment Facility-World Bank (GEF-WB)
Inter-American Development Bank (IDB)
IUCN (The World Conservation Union)
The John D. and Catherine T. MacArthur Foundation
The C.S. Mott Foundation
The Nature Conservancy (TNC)
Rockefeller Brothers Fund
The Rockefeller Foundation
Smithsonian Institution
The Synergos Institute
United Nations Environment Programme (UNEP)
United Nations Development Programme (UNDP)
U.S. Agency for International Development (USAID)
U.S. Department of State
The World Bank
World Resources Institute (WRI)
World Wildlife Fund/World Wide Fund for Nature (WWF)

The IPG is chaired by a representative from the UNDP GEF staff.

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Executive Summary

Environmental funds are an innovative financing mechanism being used by more than two dozen countries to cover the recurrent costs of parks and protected areas, to support the overall goal of conserving biological diversity, to reduce air and water pollution, to strengthen local environmental institutions, or to promote sustainable development in general. Most of such funds are independent of government, and most include on their governing board, often in a major way, representatives of nongovernmental organizations (NGOs).

Funds can take several different forms—a trust set up by special legislation, a foundation, a common law trust, a nonprofit corporation—and can receive financing from different sources—debt-for-nature swaps through governments or an international NGO, bilateral debt conversion or direct grant assistance, bequests or grants from in-country individuals or from private companies, fees for visits to parks or levies for the use of natural resources, grants from private foundations, from the Global Environment Facility (GEF), and from other multilateral institutions, and direct contributions from national treasuries.

These financing mechanisms are attractive for a number of reasons. They provide stable financing for many activities that by definition do not fit into classical development projects; this is especially important in countries struggling with external debt and unreliable, insufficient national budgets. As a national mechanism to disburse funds in appropriately sized grants, a fund allows donors to move large sums of money with minimal overhead costs without at the same time swamping beneficiaries with money they cannot absorb. When they involve domestic management of assets, these funds instill a sense of ownership and responsibility for environmental conservation, build local capacity for

financial management, and reduce the dependence on outside experts and international NGOs.

By providing an assurance of financing in perpetuity or over a long period of time, funds that are endowments allow governments and NGOs to do long-term planning on, for example, national parks, and they give individuals building careers in such fields some assurance that jobs will be available. When they are tied to a national environmental action plan, they help donors identify priority areas for funding and avoid inadvertent duplication of efforts. Last—and, some would say, most important—by including a wide range of “stakeholders” in the governance and management, funds promote democracy, strong civil societies, accountability, and consensus-building, and they build national capacity for moving toward sustainable development.

Donors and fund managers need to address a number of issues when establishing an environmental fund. This report draws on some five years of experience—from Bolivia to Poland, from Uganda to the Philippines—for useful lessons on designing environmental trust funds or foundations.

The report discusses:

- *technical scope*: a single national park or protected area; all national parks; biodiversity in general; the environment in general; sustainable development
- *relationship to government policy*: linked to a national conservation strategy or similar plan; linked to specific conservation goals; unrelated to policy
- *legal status*: trust fund or foundation; tax and charitable status

- *composition of governing board*: all government; all NGO; mixed government/NGO
- *donor role*: voting seat on governing board; options for visibility
- *monitoring and evaluation*: components that need periodic review
- *financial structure*: endowment; revolving fund; sinking fund
- *sources of funding*: bilateral debt reduction; debt-for-nature swaps; grants from the GEF, UNDP, or governments
- *location of trust and assets*: domestic; off-shore; through a multilateral agency

There is no one answer to any of these various design and management considerations—no “ideal environmental fund.” The needs of beneficiaries and donors and the domestic situation in each country differ far too much for that to be possible. Nor does the report suggest that donors should consider environmental funds as the exclusive

means of tackling environmental improvement in developing countries. This mechanism is but one way to support sustainable development initiatives—one that complements classical direct project support.

Yet donors are increasingly interested in this financing mechanism. The U.S. Agency for International Development has supported the establishment of more than a dozen funds around the world through various mechanisms, including the Enterprise for the Americas Initiative, debt swaps, and direct funding. The GEF supported 11 trust-like funds during 1991-94. And the possibility of using national funds is mentioned in the international convention on desertification, and is being discussed by the parties to the biodiversity convention.

Environmental trust funds and foundations hold the potential to meet many needs of both donors and recipients.

Environmental funds are an innovative financing mechanism being used by more than two dozen countries to cover the recurrent costs of parks and protected areas, to support the overall goal of conserving biological diversity, to reduce air and water pollution, to strengthen local environmental institutions, or to promote sustainable development in general. Most environmental funds are independent of government. And most of them include on their governing board, often in a major way, representatives of nongovernmental organizations (NGOs). They function as in-country donors that award grants to NGOs and government agencies.

As this description indicates, environmental trust funds and foundations can meet many different needs. Indeed, one of the strengths of this legal and financial mechanism that has recently been adapted to the environmental field is that it can be molded to the varying specific requirements of donors, beneficiaries, and developing-country governments.

This report looks at key issues that should be considered during any such process. It draws on the range of experience to date to describe different possible answers to questions concerning goals and objectives, management, and finance. Several boxes are included with a few details of projects supported by funds, to illustrate the range of activities covered to date.

In no way does this report attempt to describe an "ideal environmental fund," however, for no such institution exists. The needs of beneficiaries and donors and the domestic situation in each country differ far too much for that to be possible. Nor does the report suggest that donors should consider environmental funds as the exclusive means of tackling environmental improvement in developing

countries. This mechanism is but one way to support sustainable development initiatives—one that complements classical direct project support.

Although this use of trust funds and foundations is too new to allow much significant analysis of success to date, some five years of experience—from Bolivia to Poland, from Uganda to the Philippines—have provided useful lessons on designing these bodies and compelling reasons to continue supporting and creating them. Any attempts to set up a new fund should of course involve legal and financial experts from the beneficiary country. The issues discussed here are ones those professionals and the fund managers would want to consider, although it is not an exhaustive list. Other design considerations will no doubt become clear as donors, governments, and beneficiaries gain more experience.

Overview of Environmental Funds

Types of Funds

Since 1990, at least US\$850 million has been committed to environmental funds in more than 20 countries. (See Appendix 1 for a list of existing and prospective funds.) At the first Global Forum of fund managers, held in mid-1994 in Bolivia, participants agreed on a definition that includes several common characteristics:

A fund organizes environmental funding by coordinating a portfolio of projects and programs and by facilitating communication among donors. It creates a broad and diverse fund-raising program to support both start-up and long-term implementation. It manages funding through an investment strategy aimed at influencing government and private

spending and by providing transparent, effective, service-oriented management of grant programs and project funding.

Funds can take several different forms—a trust set up by special legislation, a foundation, a common law trust, or a nonprofit corporation. And they can receive financing from different sources:

- debt-for-nature swaps through governments or an international NGO,
- bilateral debt conversion or direct grant assistance,
- bequests or grants from in-country individuals or from private companies,
- fees for visits to parks or levies for the use of natural resources,
- grants from private foundations, from the Global Environment Facility (GEF), and from other multilateral institutions, and
- direct contributions from national treasuries.

National environment funds on pollution abatement exist in a number of Central and East European countries. All these so-called brown funds are part of government and were established or redesigned during the transition from centrally planned economies. They deal with air and water pollution and are funded by fines and levies on industrial activity. Although they play an important role in environmental protection in this part of the world, they were not considered for the purposes of this report as they are essentially branches of the ministries of environment of these nations. (A separate and independent fund focused on "brown" as well as "green" issues and funded by three debt swaps also exists in Poland.)

Benefits of Environmental Funds

Environmental funds are attractive for a number of reasons. They provide stable financing for many activities that by definition do not fit into classical development projects; this is especially important in countries struggling with external debt and unreliable, insufficient national budgets. This long-term stability in funding provides a degree of insulation for local NGOs by ensuring a dependable flow of grant money not affected by fluctuations in international donor or foundation money.

As a national mechanism to disburse funds in appropriately sized grants, a fund also allows

donors to move large sums of money with minimal overhead costs without at the same time swamping beneficiaries with money they cannot absorb. When they involve domestic management of assets, these funds instill a sense of ownership and responsibility for environmental conservation, build local capacity for financial management, and reduce the dependence on outside experts and international NGOs.

By providing an assurance of funds in perpetuity or over a long period of time, funds that are endowments allow governments and NGOs to do long-term planning on, for example, national parks. And they give individuals building careers in such fields some assurance that jobs will be available. When tied to a national environmental action plan, funds help donors identify priority areas for funding and avoid inadvertent duplication of efforts. Last—and, some would say, most important—by including a wide range of "stakeholders" in the governance and management, funds promote democracy, strong civil societies, accountability, and consensus-building, and they build national capacity for moving toward sustainable development.

Donors seem increasingly interested in this financing mechanism. The U.S. Agency for International Development (USAID) has supported the establishment of more than a dozen funds around the world through various mechanisms, including the Enterprise for the Americas Initiative (EAI), debt swaps, and direct funding. The GEF supported 11 trust-like funds during 1991-94. And the possibility of using national funds is mentioned in the international convention on desertification, and is being discussed by the parties to the biodiversity convention.

A possible concern for some donors, especially when setting up an endowment, is the need to release a sizable amount of money at the start of a project rather than disbursing loans, credits, and grants over time. A series of smaller appropriations over several years could be a solution. So could joint donor efforts. On the other hand, making a large grant in the beginning could be viewed positively by donors as a way of reducing administrative costs and assuring program continuity.

Another possible dilemma for donors is deciding whether to use a large amount of money on a

series of immediate impact programs or to tie it up in a trust fund that generates smaller amounts on an annual basis but larger amounts in the long term. One answer to this is to use a combination of approaches in a country.

Goals and Objectives

Technical Scope

One of the first decisions to be made when establishing an environmental fund is its scope. This could be as specific as providing funding to cover the long-term, recurrent costs of running and maintaining a national park or protected area. This is the major focus of the various GEF-supported trust funds for biodiversity conservation. In Uganda, for example, the fund supports the Mgahinga Gorilla and the Bwindi Impenetrable National Parks.

Similarly, Conservation International is working with the ACT fund in Madagascar to support the Zahamena reserve project. And in Ghana it is collaborating with other groups to try to set up a trust fund for the preservation of the Kakum National Park. Taking a slightly broader view, in Jamaica one of the two environmental funds is the Jamaica National Parks Trust, which is the vehicle for all eligible funds to the park system, whether public or private.

One advantage of a focus on parks and park systems is that the issue has a defined and vocal constituency, both domestically and internationally. The mission is easy to understand, and the sources of disagreement on any governing board are likely to be fewer. Establishing a fund with a narrow focus may also appeal to private foundations in industrial countries that have support of national parks as one of their own specific objectives.

More funds, however, include the broader goal of preserving biological diversity. They support such activities as:

- an inventory of biological resources,
- the management of buffer zones outside protected areas, or
- efforts to provide sustainable livelihoods for those who live in or around such areas.

One of the goals of the Indonesian Biodiversity Foundation, for example, is "to foster and improve

the capabilities of society and its institutions to play a role in efforts for the conservation and utilization of biodiversity in a fair, equitable, and sustainable manner."

Some funds cast the net even wider than preservation of biodiversity. They attempt to cover the full range of environmental issues. The Fondo Nacional Para El Medio Ambiente (FONAMA) in Bolivia is perhaps the most well known example of this; it is a branch of the government, and all funding for the environment must go through it. FONAMA has been described as a facilitator institution that receives, programs, and administers both external and internal investments in sustainable development and the environment.

Similarly, Ecofondo in Colombia, an NGO affiliated with 261 national NGOs and 27 government agencies, covers a wide range of issues. And in Poland, the EcoFund Foundation that was set up in 1992 with moneys from three debt swaps has—in addition to the goal of protecting biodiversity—the more traditional environmental objectives of preventing transboundary pollution, reducing greenhouse gas emissions, and improving the efficiency of power generation.

The broadest category of objectives often includes the goal of capacity building for both government environment agencies and NGOs. Since donors have traditionally found it hard to fund training, information gathering, and planning projects because the products are less tangible and because progress is difficult to measure, some funds have found it useful to include the explicit goal of building the capacity of both governments and grassroots organizations to fill these roles. The Fondo Mexicano Para la Conservación de la Naturaleza, for instance, has strengthening the capacity of Mexican NGOs as a main objective.

An argument can be made in some countries for having broad goals, and for building flexibility into a trust fund or foundation from the start. This allows the governing board to adjust the focus of funding in light of emerging scientific or other information, which an institution limited to specific purposes would have more trouble doing. It could also mean that the fund can experiment with novel forms of partnerships between the public and private sectors.

Bhutan: The First Endowment

In March 1991, a Memorandum of Understanding was signed by the Royal Government of Bhutan (RGOB), the World Wildlife Fund (WWF), and the U.N. Development Programme (UNDP) to establish the Bhutan trust Fund for Environmental Conservation, in one of the poorest countries in the world.

In early 1995, the fund stood at US\$14 million. The goal is to raise US\$20 million, which should yield about US\$1 million a year in interest. The principal is invested by UNDP and by an international investment bank; most of the income is spent on projects approved by the Management Board, although a portion of it is reinvested to hedge against inflation and to maintain its real value.

Activities covered include:

- training and professional development,
- surveys of Bhutan's forest resources and the development of an ecological information base,
- the development and management of protected areas,
- support for institutions charged with implementing the National Environmental Strategy,
- improving environmental education in schools and public awareness of the issues, and
- projects that integrate conservation and development.

The Management Board includes two government representatives, one Bhutanese NGO representative, one person from WWF, and a UNDP representative. Decisions currently require four out of five votes, although if the Board becomes larger, safeguards are in place to ensure that no decision can be passed against the combined opposition of two of the non-Bhutanese parties to the agreement. Projects are implemented by the RGOB or by an appropriate body designated by the government.

Because trust funds or foundations, particularly endowments, are by definition long-term instruments, there may be some concern that the original objectives could be altered under future management or changed national circumstances, and that moneys could be used for other purposes. To provide both flexibility and protection, the legal document setting up the fund could specify that the trust can accept moneys for restricted purposes for projects that are nonetheless consistent with the original objectives.

Relationship to Government Policy

Whether the goal is running one national park or handling all national financing for the environment, the fund's relation to national policy is a separate issue that needs to be addressed. Some funds have specific links to a national environment plan; those with the broadest objectives of environmental conservation can use such plans to establish funding priorities. This is what happened in Bolivia, where an 18-month public consultation process led by the executive branch resulted in an environmental plan that is constantly reviewed and provides the framework for FONAMA's

decisions on grants. This process created the political will about national priorities on the environment, which can be crucial for success of a fund.

When a fund is linked closely with a national environmental strategy, it is important to be clear that the fund is not a substitute for the government's existing budget for environmental protection. The Bhutan Trust for Environmental Conservation—the first endowment of this kind to be established—is the only one to make that point explicit. The Memorandum of Understanding that established the trust included a pledge from the government to maintain its current support for conservation, and even to increase that budget in nominal terms to adjust for inflation. Indeed, to demonstrate to the international community its commitment to conservation, the government agreed to maintain approximately 60 percent of the country's land area under forest cover in perpetuity and approximately 20 percent of its area as protected areas—the current percentages for these two categories—and to take certain remedial actions if the reality ever falls short of these percentages.

Management

Legal Status

As noted earlier, an environmental fund can take one of several legal forms:

- a foundation,
- a nonprofit corporation,
- a common law trust, or
- a trust established by act of a national legislature.

To some extent, this is determined by the underlying legal system of the country involved. Trust funds are recognized in common law systems—those based on law as developed and applied in the British Commonwealth countries and the United States. Under civil law, the most appropriate substitute for a charitable trust is usually a foundation.

If the fund hopes to attract contributions from individuals or from private foundations in the future, consideration should be given to obtaining charitable status. In some cases, this will entail changes in the tax law.

The whole issue of taxes needs to be studied carefully when establishing an environmental fund. One goal should be to avoid tax on the local entity that receives income and distributes it, as well as on the investment account itself. This can be achieved several ways. (See Table 1.)

Although the funds in Brazil and Bolivia are part of government, most environmental trust funds and

foundations are independent and outside of government, which can increase donor confidence that moneys will not be inefficiently used or redirected to other government programs. (One problem with locating the fund within government is that its role can change unexpectedly after an election, as happened in Bolivia after August 1993, when the new government broadened the mission of FONAMA.) In some cases—for the receipt of USAID funds, for example—an independent, nongovernmental organization must be established. (Its board may include government representatives, but must have an NGO majority.) An independent fund that has a strong international NGO presence could be perceived as a foreign creation being imposed by outsiders, which could diminish the sense of national ownership. No funds have found this to be a problem thus far, however.

Composition of Governing Board

Reaching agreement on the structure and membership of the governing board has universally been the most difficult and time-consuming aspect of setting up a trust fund or foundation. In a recent report on the design of trust funds for biodiversity conservation, the World Bank noted that extreme care must be taken so that a board

- remains functional (not too large, not too political, and able to meet reasonably frequently);
- has an internal check and balance system to prevent domination by one constituency;
- represents the critical stakeholders for the project; and

Table 1: Examples of Taxation Situation

MBIFCT, Uganda	Established as an independent, tax-exempt entity under Ugandan law; assets held offshore in a tax haven
Fiduciary Account for National System of Protected Areas, Bolivia	Housed within FONAMA; assets managed by a private investment bank in the United States and qualify as tax-exempt investments of a foreign government
Trust Fund for Environmental Conservation, Bhutan	Established as a tax-exempt entity under auspices of UNDP; assets handled by UNDP Treasury Section and by a private investment bank in New York

Source: Based on Environment Department, World Bank, "Issues and Options in the Design of Global Environment Facility Supported Trust Funds for Biodiversity Conservation," May 1994.

- embodies or has access to special expertise on environmental, financial, and legal issues.

These points can be addressed by the way membership, voting, and advisory systems are structured.

One of the basic principles of the funds established to date—in line with growing recognition of the importance of participatory democracy—is that governance will be open and transparent. Nearly all funds include NGO representatives on the governing board or council responsible for decisions on grants. (USAID guidelines actually require that NGOs constitute the voting majority on any decisionmaking body of a fund they support.)

The World Wildlife Fund (WWF) has prepared a succinct summary of the pros and cons of three primary governance structures—funds associated with a government agency, those with an entirely NGO governing board, and those with a mixed government/NGO board. (See Table 2.)

Getting the right balance is important:

- Having too strong an identification with government can tempt local officials to see the fund as a branch of the ministry, and to be unwilling to share power.
- Having too strong an identification with the NGO community can lead some officials and donors to not take the fund seriously.
- Having too strong an identification with a single NGO can create tensions in the local NGO community and make the fund as one-sided as if it were a branch of the government.

Once again, the extent of each of these problems varies greatly. In Indonesia and the Philippines, for instance, NGOs are so prevalent and such an accepted part of society that nongovernmental boards are not a problem. In the Philippines, a representative of the Department of Finance sits on the board as an *ex officio*, nonvoting member.

Providing one model of how to include the private sector in governing boards, the proposed National Conservation Trust Fund for Papua New Guinea is expected to include mining industry representatives on its board. Other funds being proposed may include seats for individuals from the timber, oil, and tourism industries. "Nongovernmental" in these cases is not restricted to environment or development groups.

One way to meet various donors' requirements for or interests in different balances in board representation is to have subaccounts within a larger, umbrella environmental fund. This is the approach followed in Bolivia, where at least 17 subaccounts have been established. Some of these have NGO majorities on their governing bodies, known as Administrative Councils; some have government majorities; and some have equal NGO-government representation. Similarly, Ecofondo in Colombia manages its funds through two subaccounts.

To be truly representative, some funds take extra steps to ensure that the NGOs included are not just the large, urban-based ones—those already well known to international donors. In Bolivia, for example, when a FONAMA subaccount was established for the EAI funds made available through a debt reduction agreement, a conference of NGOs was

Environmental Education in the Philippines

In the Philippines, more than 100 projects have received grants since 1992 from the Foundation for the Philippine Environment (FPE), covering a wide range of activities. In addition to supporting training and specific projects in the field, environmental education for the public has been an important focus.

Projects receiving support include a youth ecology camp, a book on sustainable development, sponsorship of an artist to work on a field guide to birds in the Philippines, and the development of a puppet show focusing on indigenous cultural communities and environmental protection.

Many forums, workshops, and conferences have been supported by FPE: on national parks, on biodiversity and indigenous natural resource management practices, on the ecological and economic importance of multipurpose tree species, and on conservation-based enterprises, to name a few.

Table 2: Comparison of Fund-Governing Structures

Funds Associated with a Government Agency

Advantages:

- Can be a tool for implementing national environmental strategies and effecting policy changes.
- Can provide a way to organize and coordinate official development assistance for the environmental sector.
- Can provide support for underfunded governmental responsibilities, such as park guard salaries, protected area infrastructure, and so on.
- Can be a recipient for earmarked taxes, fines, and permit fees.
- May be better suited than NGO funds for pollution management and restoration of degraded resources because of the large financial and management resources required.

Disadvantages:

- Personnel, programs, and policies can be subject to sudden political changes.
- Can be top-down in approach and insufficiently responsive to local needs.
- NGO and local community suspicion of government.
- Can be bureaucratic and restricted by civil service rules and government pay scales.

Funds with a Governing Board Composed Entirely of NGOs

Advantages:

- Likely to be responsive to local needs, based on popular participation.
- Promotes values of democratization and local participation.
- Able to integrate grass-roots economic and social development with environmental programs.
- Well suited for institution strengthening of local NGOs and providing support to local grass-roots projects.
- Independent of changes in government, thus offers institutional continuity.
- Can serve as a vehicle for private donations (individual, corporate, and foundation).

Disadvantages:

- With a diverse group of NGOs, it can be difficult to reach consensus on programs, policies, and implementation.
- Not being associated with government can mean that it is hard to influence national environmental strategies and policy reform.
- Generally unable or uninterested in funding governmental responsibilities, such as park guard salaries, protected area infrastructure, and so on, which may be essential for biodiversity conservation.
- Generally unable to serve as recipient for government-levied taxes, fines, and permit fees.

Funds with a Mixed Government/NGO Governing Board

Advantages:

- Can serve to institutionalize cooperation between the public and private sectors, replacing previous patterns of confrontation.
- Can combine most of the advantages offered by both of the other two types of funds, while avoiding many of their limitations.
- Likely to result in projects that are sustainable in the long run, by combining local initiative with government support.

Disadvantages:

- Citizens of the country may be confused about whether or not to regard the fund as an official government organization.
- Likelier to suffer from lack of focus than the other two types of funds, if purposes and project criteria are not clearly specified at the outset.
- If the NGO side always has a clear majority, then the government may not take the fund as seriously or commit as many resources as it would to a government fund; if the government side always has a clear majority, the NGOs may be taken for granted and they may simply focus on getting near-term funding for their own projects.

held. Two hundred and fifty environmental, development, local community, and scientific organizations were invited to nominate eight individuals to serve on the Administrative Council of this account. The government then selected one of the two nominees in each of the four categories of organizations to fill four NGO seats on the six-person Council. The government and USAID have one seat each.

Ecofondo has a two-tiered structure that allows full representation of all interested groups. A General Assembly of some 300 individuals from NGOs and government agencies defines statutes and approves the overall budget. It also elects the five NGO representatives who sit on the seven-member Board of Directors. (Regional Councils have also been set up there to review proposed projects and help establish environmental priorities.)

A different approach has been taken in Uganda. A Local Community Steering Committee has been set up to ensure that decisions by the Mgahinga and Bwindi Impenetrable Forest Conservation Trust (MBIFCT) take into account the concerns of those who live near and work in the two parks. The Local Committee can approve grants for up to US\$1,000, and forwards proposals for larger grants to the Board of Directors with a recommendation. The group also chooses three of its own members to serve as voting members on the MBIFCT Board.

Donor Role

The role of donors in environmental funds is less clear. And the experience to date is even more varied than in the composition of the governing board. Funds that have donors on their boards or administrative councils in a voting capacity include Bhutan, Bolivia, Chile, El Salvador, Jamaica's Environmental Foundation, Peru, and Poland. Donors understandably may want to have some say

in how their funds are used, especially in situations where an endowment is being set up with a large capital base of donor funds and with operating funds derived from the interest. USAID, on the other hand, uses two approaches: for EAI funds, legislation requires a U.S. government representative as a voting member; for other funds, USAID policy specifies that if an employee is on the board, he or she must serve in an ex officio, nonvoting capacity.

Arguments against having a representative of a major donor on the board include that it can detract from the national "sense of ownership" regarding the fund, thereby diminishing local commitment to the fund's goals. It can also discourage other donors from becoming involved if they perceive that the fund is too closely associated with a particular bilateral agency, private foundation, or similar donor.

One way to counter this perception yet maintain a role for donors in decisionmaking is for one donor or a neutral party to represent all donors on the board. In Bhutan, the U.N. Development Programme (UNDP) performs this function in a fund that has received financing from the governments of the Netherlands and Norway and from the GEF.

Sometimes donors need more than just a say in decisionmaking; they need to play a visible role. This is easier to accomplish in a system of subaccounts, as in the case of Bolivia described earlier, where the donor can be seen to participate in the administrative council for that particular account. This approach is also appropriate for donors who are not interested in working through an intermediary representative such as UNDP.

Monitoring and Evaluation

All environmental funds established to date have auditing systems in place. Beyond this, however,

Reforestation in the Dominican Republic

PRONATURA, in the Dominican Republic, is a consortium of 14 NGOs working on conservation and sustainable development. The Board of Directors has seven representatives from seven of these groups. Proposals are reviewed by a selection committee that includes representatives from donors, international partner organizations, government, and NGOs.

Projects supported to date include reforestation of the Arroyo Parra watershed, training and equipment for guards at the Ebano Verde Scientific Reserve, establishment of an interpretation trail and an ecomuseum in the Isla Cabritos National Park, and the completion of a marine biodiversity survey.

Protection of a Reserve in Madagascar

Work in the Zahamena Reserve in Madagascar has focused in part on the priority conservation zones that surround the area. Some 10 percent of the 10,000 villagers that constitute the target population have organized themselves into cooperatives to work directly with the project supported by USAID and Conservation International.

Each of the 63 village-level, member-owned cooperatives has 15-40 associates. They run commercial enterprises such as granaries and beekeeping in order to provide villagers with livelihoods that do not involve destruction of the reserve. Vegetable production is another supported activity, which not only produces a cash income but also attacks the vitamin deficiency that is a major problem in the area year round.

many have given some thought to setting up monitoring and evaluation systems both for investment performance and assessment of whether their grants are reaching the intended recipients and achieving their stated goals.

The World Bank noted that some or all of the following points need periodic review:

- asset management performance;
- the adequacy of project selection criteria and application, including the impact of the activities financed;
- the amounts disbursed at the field level; and
- the representativeness of individuals serving on the Board of Directors and on committees.

Furthermore, the Bank notes, the consequences of a less than satisfactory review should be included in the deed setting up the trust fund or foundation.

To help monitor its investments, Ecofondo in Colombia has a financial advisory board with private-sector representatives who make recommendations on where to invest the fund's assets.

Such monitoring could bring to light cases where net returns on investment are falling short of expectations, or where needs are exceeding the net income available. The by-laws of the fund can specify what to do in such situations. Some of the possible options are looking for emergency funds from another donor to cover the shortfall, setting aside a small portion of the annual return on any endowment fund to act as insurance against such an event, dipping into the principal of an endowment, or disbursing the funds available in a given year only to projects given the highest priority by the Board of Directors.

The terms of a fund should also specify whether and under what conditions the fund should be dissolved and its assets returned to the donors. Although moneys in an irrevocable fund cannot revert to the donor, the Board of Directors could be given the power to dissolve such a trust and transfer the assets to another one with comparable objectives if evaluation of the current fund determined that its own objectives were not being met.

Finance

While reaching agreement on the governing board may be the most time-consuming task, settling on the financial structure and the location of the assets may be the most complex. As the World Bank's study of issues and options in designing biodiversity trusts notes:

To date, no ideal solution has been found to create a fully tax free trust, with no risk to attachment, full security of assets, and a guarantee that the objectives will not be frustrated. Trade-offs must be made in such a way that the most critical needs are met and risk is manageable.

Structure

The first choice regarding financial structure to be made (whether the legal mechanism being used is a trust fund, a foundation, or some other option) is whether to set up an endowment, a revolving fund, or a sinking fund.

- An endowment maintains as principal all the money originally raised to set it up, and disburses only the income earned from investing this principal.
- A revolving fund has new assets added periodically (each year, for example), usually

Protected Areas in Peru

PROFONANPE in Peru is supported by GTZ (the German development agency) and the Global Environment Facility and has commitments from or is negotiating with the governments of Canada, Finland, and the Netherlands. It will finance projects for the conservation and sustainable use of soils, flora, and fauna in national reserves as well as in surrounding areas.

Activities to be funded include implementing management plans for protected areas, establishing and managing buffer zones, providing institutional support for the government's Division of Protected Areas, training professionals in park management and operation, and creating public awareness programs.

through fees, levies, or special taxes collected by the government; it can disburse the money collected and can also set aside a certain percentage to create an endowment that can be drawn on in case of need.

- A sinking fund is designed to disburse all its principal plus any income earned over a designated period of time. (Even this should not be considered a short-term organization, however. USAID, for instance, recommends that the principal of a sinking fund should not be drawn down faster than over 10-15 years.)

Nearly all the trust funds or foundations considered for this report are endowments. Even the funds established with debt swaps that will be paid in over 15 years under the Enterprise for the Americas Initiative can be set up as endowments; although the contributions from the swap cease, what is done with the moneys is up to the Board of Directors.

One sinking fund is PRONATURA in the Dominican Republic, which has disbursed some US\$1 million to 25 projects since 1991. Consideration is being given, however, to setting up a revolving fund or endowment there instead.

The fund being designed in Belize, the Protected Area Conservation Trust, is an example of a revolving fund. Visitor fees of US\$10 will be collected from foreigners arriving by air or by sea; other sources of income will include a share of all park entry fees, recreational licenses, permit fees, concession fees, and fines. This fund illustrates the importance of flexibility in original design, for it is also able to accept grants from international donors, which will go into a parallel endowment fund.

The subaccount approach mentioned earlier allows funds to include all three financial structures if that would better meet donor needs. Subaccounts organized by donor have been established in Bolivia, Chile, Colombia, and El Salvador.

To lower the chances that moneys will be insufficient over the long term, the by-laws of a revolving fund might include "spending rules" on what percentage of the investment portfolio can be spent each year on administrative costs and specified project activities. The World Bank suggests as one rule of thumb that only 5 percent of the three-year moving average of the value of the investment portfolio be available for disbursement in any given year.

A related issue for endowment funds is possible depreciation in value of the principal. Many asset managers reinvest some of the income earned each year to ensure that the principal maintains its real value against inflation.

Sources of Funding

So far, the major sources of finance for environmental funds have been bilateral debt conversion agreements, debt-for-nature swaps, and grants from the GEF, UNDP, and several governments.

In debt conversions, a debtor is allowed to discharge a portion of debt when it agrees to pay for specified activities in its own country; in most of these, official development assistance debt has been converted into local currencies to fund development-related projects. In the case of commercial debt swaps, an international NGO is often involved in arranging and jointly managing the moneys generated. Since 1987, at least US\$120 million of commercial debt (full value) has been

exchanged, generating approximately US\$75 million for conservation overall (although not just for trust funds or foundations).

In a typical swap, a developing country's debt is purchased at a discount on the secondary market by a donor and redeemed in local currency or government bonds at a higher value in return for agreed-on conservation activities to be undertaken by the debtor government. Each participant benefits:

- the donor's grant is leveraged through purchasing the debt at a substantial discount,
- the developing country retires some of its debt,
- local environmental groups receive some funds to support their activities, and
- environmental conservation is advanced all around.

Yet these swaps are not problem-free. The debtor government often needs to come up with a considerable sum of local currency to pay for the environmental projects and activities—money that otherwise could have been allocated to education, housing, or other development priorities. The government may even resent being asked to come up with, say, 25 percent of a total debt package when other governments have had 100 percent of their debt written off. In addition, the swap can have an inflationary effect, although this can be countered by providing the assets in the form of long-term local-currency bonds paying out interest and principal for 10-30 years. The bonds can be indexed to the dollar to protect against inflation and devaluation.

The possible problems of keeping the assets in local currency need to be considered early. In

Madagascar, for example, US\$1.3 million is being held in local currency after a debt swap while matching funds are sought; the principal lost considerable value when the franc devalued 50 percent as soon as it started to float recently. (The issues of where the trust is based and where the assets are held are discussed in the next section.)

Another major source of funds is the GEF, which as noted earlier is supporting 11 trust-like national or regional funds on biodiversity conservation—in Belarus, Bhutan, Bolivia, Brazil, Congo, the East Carpathian region (Poland, the Slovak Republic, and Ukraine), Laos, Peru, the Seychelles, Uganda, and the Ukraine-Danube Delta. The GEF grants have focused on covering the long-term, recurrent costs of protected areas or providing alternative livelihoods for communities putting pressure on such areas.

Other, more traditional sources of development assistance can also be channeled into environmental funds. The Brazilian National Environmental Fund (FNMA), for instance, was established in 1989 with a four-year loan of US\$22 million from the Inter-American Development Bank.

Nonprofit foundations are beginning to look at the potential for environmental funds. A private U.K. foundation contributed the bulk of the money for the Guatemalan Trust Fund for Environmental Conservation, and the MacArthur Foundation in the United States has made substantial contributions to Fondo Mexicano Para la Conservación de la Naturaleza in Mexico, PRONATURA in the Dominican Republic, and the Foundation for Eastern Carpathian Biodiversity Conservation.

Private corporations and banks have also become a means of support. The Bank of Tokyo, for example,

A Regional Fund in Eastern Europe

Environmental funds have the potential to be useful in bioregions that are not confined to national borders. The Foundation for Eastern Carpathian Biodiversity Conservation, for example, was set up in Switzerland in 1994 to fund activities that protect the overall biodiversity of the region, such as strategies for the formation of stable forest ecosystems, the conservation of genetic resources, and environmental monitoring.

Each participating country—Poland, the Slovak Republic, and Ukraine—has four members on the governing board. Other members include a representative of WWF and one from the MacArthur Foundation, which provided support for designing the foundation as well as an initial contribution of US\$300,000. The foundation is also receiving US\$300,000 from the Global Environment Facility.

donated to the Foundation for the Philippine Environment US\$200,000 of Philippine commercial debt that it held. And J.P. Morgan Bank donated US\$1.5 million worth of debt to Bolivia's FONAMA for protected areas. Along similar lines, there are indications that some oil companies and parts of the tourism industry might be interested in becoming involved in environmental funds.

A last source of funds is fees, levies, and specially earmarked taxes collected by governments. As noted, Belize will raise money for its revolving fund through a tourist tax and fees on the use of the park system. The Jamaica National Park Trust Fund expects user fees and leases to be one source of its revenue. And the fund being proposed in Papua New Guinea may draw on a new environmental levy on mining, oil and timber extraction, and fisheries. In the future, particularly for "brown funds" that deal more with pollution abatement, user charges may take the form of fines and penalties for contamination of air and water.

The sources just described are not mutually exclusive. Indeed, Conservation International notes that

it is likely that many endowments in the future may owe their existence to a combination of local currency funding arising from debt swaps and financing from local sources along with counterpart hard currency funds kept offshore, so as to offset the impact of fluctuating local currency rates.

Whatever the source of financing, it is important that responsibility for seeking and securing other donors, especially if there is a funding shortfall, is agreed early in discussions on trust design. As for the minimum size of a fund, the World Bank report suggested as a general guideline US\$5-10 million, depending on how the assets will be managed.

Donors have several options for supporting environmental funds, and different approaches will be appropriate in different situations. The options to consider include:

- financing startup costs,
- covering administrative costs during the first year or two to allow for asset growth in the case of endowed trusts,
- making medium- to long-term commitments for annual replenishments,
- arranging commercial or bilateral debt swaps to increase the local-currency value of trust fund or foundation contributions,
- capitalizing permanent endowment or sinking fund trusts,
- setting up special-purpose subaccounts within existing funds,
- financing specific projects that are part of a fund's portfolio of priority investments, and
- contributing counterpart funds to trust funds or foundations.

Location of Trust and Assets

There are nearly as many answers to the questions of where to establish a trust and invest its assets as there are environmental funds. To name just a few:

- Uganda has a domestic trust with assets managed in London and the account held in that bank's Channel Island branch.
- Bolivia's GEF fund is set up as a subaccount within FONAMA, the existing umbrella institution, with both a domestic trustee and an off-shore U.S. commercial bank serving as cotrustees and responsible for managing the assets.
- Panama's funds will be managed in the United States by an international NGO, although investment can be in Panama.
- Bhutan's trust was set up within UNDP, and its assets, in New York, are managed partly by a private investment bank and partly by UNDP's Treasury Section.

Sometimes donors' legal restrictions determine the arrangement. USAID funds, for example, must be in U.S. dollar accounts managed by a U.S.-based financial intermediary, although this could be a U.S.-based mutual fund investing overseas. (USAID does permit, however, foreign-currency endowments derived from debt swaps to be invested locally without a U.S. financial intermediary.)

The World Bank's recent report on biodiversity conservation trust funds detailed the pros and cons of three basic arrangements. (See Table 3.) The same considerations apply to funds or foundations dealing with broader environmental goals.

Table 3: Location of Trust

Domestic Trust

Advantages:

- Functions under laws of country of beneficiaries.
- Builds domestic capacity in trust management; if assets held domestically, also strengthens financial management capacity.
- Perception of national "ownership" can raise awareness of and build commitment to environmental issues.

Disadvantages:

- Perception that funds belong to government and can be used for other government programs.
- Political instability and corruption can threaten trust objectives and safety of assets, and the risk of these can discourage donors.
- The legal status may not meet requirements of some outside nonprofit foundations that would otherwise contribute to the trust.
- Lack of access to USAID funds.
- Risk of devaluation of local currency.

Offshore Trust with Offshore Asset Management

Advantages:

- Investments in a hard currency in a secure market and location.
- Access to top professional asset managers.
- Increased donor confidence.
- Provides legal structure for countries where legal system does not accommodate a trust arrangement.
- Ability to transfer assets, in most cases, to another location if the first becomes vulnerable.

Disadvantages:

- Risk of attachment (commercial creditors' seizing of moneys owed them by a government).
- Lost opportunity to build domestic financial and asset management capabilities.
- Loss of sense of national ownership and control.

Trust Based in a Multilateral Agency

Advantages:

- Tax-exempt status.
- Security of assets.
- Protection from attachment.
- Ability to place assets in a tax haven indirectly, without negative perception sometimes associated with such a situation.

Disadvantages:

- Additional layer of administrative costs and delays.
- Long-term involvement of outside agency and lost opportunity to build domestic capacity for asset management.
- Fee arrangements and conservative investment practices can lower potential returns.
- Loss of sense of national ownership and control.

Source: Based on Environment Department, World Bank, "Issues and Options in the Design of Global Environment Facility Supported Trust Funds for Biodiversity Conservation," May 1994.

Given all these considerations of public perceptions, risk, tax status, security of assets, devaluation, and administrative costs, the Bank concluded that

very few cases will have a clear outcome; the majority of cases will fall in between a wholly domestic or wholly off-shore solution. In those cases, a domestic trust fund with an off-shore asset management account or a two-tier system may result in a workable compromise.

Conclusion

As this report indicates, environmental funds are receiving an increasing amount of interest among donors, the governments of developing countries and economies in transition, and both international and domestic NGOs. These trust funds and foundations can meet many different needs, and are sure to be a focus of attention as all parties work to solve national and global environmental problems in a cost-effective manner. The potential of this financing mechanism clearly warrants donors' attention.

Appendixes

Appendix 1

Existing and Prospective Environmental Funds

<i>Name</i>	<i>Principal Donor(s)</i>
LATIN AMERICA AND CARIBBEAN	
Argentina Fondo de las Américas	EAI
Belize Belize Protected Area Conservation Trust	tourism taxes
Bolivia Fondo Nacional Para El Medio Ambiente (FONAMA)	multiple donors with separate subaccounts, including EAI, GEF (World Bank), Switzerland, World Bank
Brazil Brazil Biodiversity Sinking Fund	Government, GEF (World Bank), private sector
Brazil Rainforest Trust Fund	European Commission, World Bank
National Environmental Fund (FNMA)	Government, IDB
Chile Fondo de las Américas	Government, EAI
Colombia Corporación Ecofondo	EAI, CIDA
Dominican Republic Fondo Integrado Pro Naturaleza (PRONATURA)	Puerto Rico Conservation Trust, MacArthur Foundation, TNC/USAID
El Salvador Fondo Ambiental de El Salvador (FONAES)	EAI, Canada
Guatemala El Fideicomiso para la Conservación en Guatemala (FCG)	U.S. private bank, U.K. foundation, WWF-US
Honduras Fundación Hondureña de Ambiente y Desarrollo "Vida" (Fundación Vida)	Government, USAID, UNDP
Honduras-Canada Environment Management Fund	CIDA
Jamaica Environment Foundation of Jamaica (EFJ)	EAI
Jamaica National Park Trust Fund (JNPT)	USAID, Conservation Trust of Puerto Rico, TNC

Mexico

Fondo Mexicano Para la Conservación de
la Naturaleza (MNCF)

Government, MacArthur Foundation,
USAID, WWF-US

Nicaragua

Nicaragua-Canada Environment Management Fund

CIDA

Panama

Fundación Natura

Government, USAID, TNC

Peru

Fondo Nacional para las Áreas Protegidas por el Estado
(FONANPE)/PROFONANPE

GEF (World Bank), GTZ (Germany), CIDA

Uruguay

Fondo de las Américas

EAI

ASIA AND THE PACIFIC**Bhutan**

Bhutan Trust Fund for Environmental Conservation

GEF (UNDP), Netherlands, Norway, WWF-US

Indonesia

Indonesian Biodiversity Foundation (IBF)

USAID, Japan

Lao PDR

Lao PDR Wildlife and Protected Areas Conservation
Project

GEF (World Bank)

Mongolia

National Biodiversity Conservation Plan

GEF (UNDP)

Papua New Guinea

National Conservation Trust Fund for Papua New Guinea

Government, GEF (UNDP), WWF-US

Philippines

Foundation for the Philippine Environment (FPE)

USAID, WWF-US

Sri Lanka

Wildlife Trust of Sri Lanka

U.S. Fish and Wildlife Service

EUROPE/ECONOMIES IN TRANSITION**Belarus/Poland**

Belovezhskaya Primeval Forest Foundation

GEF (World Bank)

Bulgaria

National Environmental Fund*

Government (pollution fines, taxes, etc.)

Czech Republic

National Environment Fund*

Government (pollution fines)

Eastern Carpathians

(Poland, Slovakia, Ukraine)

Foundation for Eastern Carpathian Biodiversity Conservation

GEF (World Bank), WWF, MacArthur Foundation

Hungary

National Environment Fund*

Government (taxes and pollution fines)

Poland

The EcoFund Foundation

France, Switzerland, USAID

National Environment Fund*

Government (pollution fines)

Slovak Republic

National Environment Fund*

Government (budget and pollution fines)

Ukraine

Ukraine Danube Delta Biodiversity Project

GEF (World Bank)

AFRICA

Congo

Congo Wildlands Protection Project

GEF (World Bank)

Madagascar

Activities Conservation Trust (ACT)

USAID, Conservation International

Seychelles

Seychelles Island Foundation

GEF (World Bank)

Uganda

Mgahinga and Bwindi Impenetrable Forest Conservation Trust

GEF (World Bank), USAID

*largely or exclusively "brown" funds to combat air and water pollution

Donor Key:	CIDA	Canadian International Development Agency
	EAI	Enterprise for the Americas Initiative (US)
	GEF	Global Environment Facility
	IDB	Inter-American Development Bank
	TNC	The Nature Conservancy
	UNDP	United Nations Development Programme
	USAID	U.S. Agency for International Development
	WWF-US	World Wildlife Fund

Appendix 2

Glossary

Attachment	A commercial creditor's seizing of fund assets that are owed to it by any branch of government.
Board of Directors	Also referred to as Board of Trustees, Management Board, or Executive Committee; the body that governs the trust fund.
Debt Conversion	A process by which a debtor is allowed to discharge a portion of its debt in return for paying for specified activities in its own country; most arrangements have converted official development assistance debt into local currencies to fund development-related projects.
Debt-for-Nature Swap	Purchase of a portion of a developing country's debt by a donor (usually an international environmental NGO) followed by redemption in local currency or government bonds at a higher value in return for agreement on conservation measures by the debtor government.
Endowment	A fund that is designed to disburse only the income earned from assets; the principal of the fund remains intact and invested.
Foundation	A trust-like arrangement used in civil law countries where there is no legal setting for trust funds; also sometimes used in common law countries.
Revolving fund	A fund that has new assets added each period (such as annually) and that disburses existing funds and income in each period; the new funds can replenish or augment the original principal.
Sinking fund	A fund that is designed to disburse its principal plus income earned over a designated period of time.
Trust fund	An arrangement in common law countries whereby assets are managed by trustees on behalf of beneficiaries under the terms of a legal trust instrument or deed.



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